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THE WAR TAX ACT OF 1917

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I

History of the Act

The tax act of 1917, unexampled tho it is as regards the amount of revenue designed to be secured, is based in some important respects on earlier measures. The preceding Congress, both in its session of 1915–16 and in its second session in 1916–17, had passed two important acts which prepared the way for the war taxes and much affected their scope and shape. The first of these was the act of September 8, 1916; the second the

act of March 3, 1917. The first started the lines of action which proved most important in 1917. The income tax was increased, the normal tax being made 2 per cent and the surtaxes correspondingly higher; the federal inheritance tax was established; and a special tax was imposed upon munition manufacturers, constituting the initial stage of the excess-profits levies which bulked so large in 1917;[1] and finally, some increase was made in the beer and wine taxes, and some special license taxes were levied. In the next act, that of March 3, 1917, passed in the second session of 1916–17, the most important further step was the general excess-profits tax. Some increase also was made in the inheritance tax. The two measures were on the statute book when consideration of the new war taxes began in the extra session of 1917. Some of their provisions are left unrepealed, the new enactment taking the shape of amendments or additional provisions; others are completely superseded. Some details of the relations between the three measures will be noted in the following pages; all need to be consulted for an understanding of the final outcome of the series of enactments.[2]

Action in the House of Representatives was prompt, and perhaps somewhat hurried. The House bill was reported by the Committee on May 9 and was passed on May 23. In the Senate discussion and deliberation were prolonged. The Senate Committee on Finance undertook a careful and conscientious revision of every

[1] A remnant of this first stage in the excess profits legislation appears in a provision in the war tax act by which a tax at the rate of 10 per cent is imposed upon the entire net profits of manufacturers of munitions. The act of September, 1916, had imposed this tax at the rate of 12½ per cent. It might have been expected that the general excess profits tax would replace it. Nevertheless, it is retained, for the single year 1917, at the slightly reduced rate of 10 per cent.

[2] Below, on pages 16 and 18 will be found tabular statements showing how the income tax rates and estate tax rates were modified in the several measures.

section of the voluminous measure. In the early part of August the Committee's consideration of the bill was thought to be concluded, when an unexpected revision of the Treasury estimate of revenue needs, and a complication due to the prohibition of the use of grain for distilling and brewing, caused the measure to be withdrawn by the Committee immediately after it was reported. In revised and more or less definitive form, it was not again submitted to the Senate until August 15. Finally passed by the Senate, September 10, it went to the Conference Committee, emerged thence on September 29, and became law on October 3.

The action of the Conference Committee was important on almost every item, and on many was almost radical. The differences between the two houses of Congress were great, and were concerned not only with matters of detail but with some fundamental questions of principle. Hardly a paragraph in the entire measure failed to carry its amendment as the bill passed the Senate. Every amendment, whether petty or of far-reaching consequence, had to be gone over in the Conference Committee. Virtually the entire measure was thus reconsidered and revised in a scant fortnight, by a group of eight men already wearied by the exigencies of a trying session, and now compelled to work under high pressure. It was inevitable that under such circumstances provisions should slip in, or should fail to be eliminated, which would have received different treatment under conditions less unfavorable. The situation is familiar, and indeed is inevitable under our constitutional system and our methods of legislative procedure. Conference committees, differently constituted for different measures, have come to be more and more the effective agents for settling the details of legislation. The practice is admitted to be far from ideal. Some of

the consequences in the measure here under consideration will be noted in the following pages.

In the earlier stages of the bill resort to a very wide range of levies was contemplated. True, there was reliance from the outset upon the income tax and the war-profits tax as the chief sources of revenue. In addition, however, much was expected from various other sources — additional import duties, taxes on communication and the like, taxes on amusements, certain additional excises, stamp taxes. Some of these additional levies were discarded at one stage or another; others, while retained, were imposed at lower rates than had been originally put down. The outcome in the measure as finally passed was that the income tax, the war-profits tax, and the higher rates of the well-established internal taxes on alcoholic liquors and on tobacco, became more pronouncedly the main revenue producers.[1]

[1] In this discussion I have not followed the order in which the several taxes are arranged in the text of the act. Following the precedent established in 1916, the present act is arranged under titles, each title having a series of sections, numbered in successive hundreds. The headings of the several titles and the numbers of the sections under them are as follows:

Title I. — War Income Tax, Section 1, seq.
Title II. — War excess profits Tax, Section 200, seq.
Title III. — War Tax on Beverages, Section 300, seq.
Title IV. — War Tax on Cigars, Tobacco, and Manufactures thereof, Section 400, seq.
Title V. — War Tax on Facilities Furnished by Public Utilities, and Insurance, Section 500, seq.
Title VI. — War Excise Taxes, Section 600, seq.
Title VII. — War Tax on Admissions and Dues, Section 700, seq.
Title VIII. — War Stamp Taxes, Section 800, seq.
Title IX. — War Estate Tax, Section 900, seq.
Title X. — Administrative Provisions, Section 1000, seq.
Title XI. — Postal Rates, Section 1100, seq.
Title XII. — Income Tax Amendments, Section 1200, seq.
Title XIII. — General Provisions, Section 1300, seq.

II

Taxes Proposed but Discarded

Among the taxes which were considered but finally discarded, may be mentioned the supplement to the income tax of 1916, increased import duties, and the so-called "consumption taxes." The supplement which the House proposed to add to the income tax of the current year was to have been one-third of the tax on the incomes of 1916 as levied under previous enactment, and was to have been collected toward the close of 1917. It was vehemently opposed as retroactive, was summarily rejected by the Senate, and not restored in Conference. To the present writer it seems by no means so indefensible as it was in many quarters thought to be. Indeed, as a war emergency tax, and moreover one which would have yielded immediate and certain revenue, it was justifiable on solid grounds. But the feeling against it was strong, and it was lost from sight in the eager discussion of the new income tax rates on the incomes of 1917 and of the excess-profits tax.

The additional import duties proposed by the House also met with little favor in the course of debate, and soon were dropped from serious consideration. The change proposed by the House Committee, and embodied in the House bill, provided for an additional duty of 10 per cent ad valorem on each and every article imported (some insignificant exceptions were made) — not a 10 per cent addition to the existing duties, but an additional duty of 10 per cent ad valorem on every commodity. All articles previously free would have been subjected to a duty of 10 per cent; articles previously subjected to a duty of 20 per cent would have become dutiable at 30 per cent; and articles previously sub-

jected to a specific duty would have become subject to compound duties, *i. e.*, the previous specific duty plus 10 per cent ad valorem. This blanket proposal was admitted by the House leaders to be open to serious objection, and its abandonment in the Senate met with general approval.

In its place the Senate Committee proposed what were entitled in the bill "excise taxes," and were popularly dubbed "consumption taxes," upon a selected list of commodities — namely, tea, coffee, cocoa and sugar. Tho called excises, they were in reality import duties in so far as they affected coffee, tea and cocoa; it was only with regard to sugar that the term excise was accurate. There seems to have been a curious unwillingness to speak of import duties by name, perhaps for fear that in some unexpected way the burning question of protection and free trade might be revived. The sugar excise was notable, in that a tax (at the rate of one-half cent a pound) was proposed on all refined sugar and other sugars suitable for consumption. The proposal was a tacit recognition of the unsatisfactory operation of the existing import duty as a revenue measure. Nevertheless, all of these "consumption taxes" disappeared in the final adjustment. Even the remnant of import duties proposed by the Senate Committee was rejected by the Senate itself and did not reëmerge in the Conference Committee.

III

New Internal Taxes

Certain other taxes finally retained are comparative novelties in the Federal finances. Some are entitled taxes "on facilities furnished by public utilities, and insurance," others are entitled "excise taxes." The simplest are the taxes on transportation and communi-

cation, clearly designed to be borne by the user or consumer. On all charges for freight transportation a tax of 3 per cent is levied; on passenger transportation one of 8 per cent; on seats and berths in parlor and sleeping cars and on vessels, 10 per cent; on express matter, roughly 5 per cent (one cent for each twenty cents or fraction); on telephone and telegraph messages other than ordinary local calls (that is, where the charge is fifteen cents or over) a tax of five cents for each message. In the bill as passed by the House there were similar taxes upon the use of gas and electric light and power, but they disappeared. All, it is expressly provided, shall be collected by the several concerns conducting the industries, which are to add them to their usual rates, and so shift them once and for all to the consumers. A somewhat different result is apparently contemplated, or at least a different possibility is foreseen, as regards the taxes imposed on the issuance of insurance policies — life insurance, marine and fire insurance, and casualty insurance. Nothing is here said of collection of the tax by the insurance companies from the persons insured. The matter of shifting is left to settle itself.

The "war excise taxes" provided for in the next succeeding title include a considerable array, as is indicated below.[1] In all cases the levy is upon "the manufacturer, producer, or importer." But there

[1] The main taxes are:

	Per cent of the prices for which sold
On automobiles	3
piano players, phonographs and records	3
jewelry, real or imitation	3
sporting goods (tennis, golf, and the like)	3
cameras	3
perfumes, essences, toilet preparations	2
patent medicines	2
chewing gum	2
moving picture films ¼ to ½ cent per foot.	

There are also annual license taxes on pleasure boats.

seems to have been some uncertainty of intention and of expectation as regards the ultimate bearers of the burden, and for this reason some hesitation with regard to the rates. Ordinarily, such taxes are "indirect," in the sense in which import duties and taxes upon tobacco and spirits are indirect: they are expected to reach the consumer, not to rest upon the producer or dealer who makes the immediate payment to the Treasury. As has just been noted, shifting to the user or consumer is expressly authorized and indeed required for the taxes upon transportation. But much was said in the debates to indicate an intention that these "excise taxes" should reach the producer, not the consumer. The industries selected are largely of the sort having some kind of monopoly, or some prospect of unusual profits for the time being such as might cause the taxes to rest on the producers. The House bill, for example, had provided for a tax of 5 per cent on motor vehicles; which was in some quarters opposed on the ground that a tax upon the manufacturers should be levied not according to gross output, but according to net earnings. The objection obviously rested on the expectation that the tax was to be paid once for all by the manufacturers, not shifted to consumers. The taxes upon cameras, moving pictures, patent medicines, and the like, suggested the same question. The sound policy would seem to be to levy taxes upon gross output strictly as excises and in such manner as to lead ordinarily to their being shifted to consumers. If designed to reach monopolistic or exceptional profits of producers — and something of the sort was doubtless held in mind for many of these excises — they should be levied with reference to net profits, not on the basis of gross output. In other words, the principle of the excess-profits tax should be applied, not that of excise taxation. As a

matter of fact, it is more than probable that in actual operation many of the new excises will bear upon the producers rather than upon the consumers. Taxes of this kind, at rates as moderate as here imposed, are likely to be absorbed in the chain of producers and middlemen even if the commodities are produced under conditions of the freest competition and under normal conditions of demand and supply. If the commodities are produced under conditions akin to monopoly, or in a period of exceptional demand and exceptional profit, such taxes are more than likely to be absorbed before reaching the final purchasers. But in so far as they so operate, they will necessarily be unequal in their incidence on the several producers or sets of producers. On this ground, they will be effectively attacked and doubtless prove temporary; they are unlikely to find a permanent place in the new system of Federal finance which must eventually develop from the war's experiences.

And yet, curiously enough, there is one important provision which seems to give clear indication that all these taxes are expected to reach the consumer. Among the administrative provisions of the act one is almost a novelty in Federal finance.[1] It provides that when contracts have been made before May 9, 1917 (the date when the bill was reported by the Ways and Means Committee to the House) the vendor under the previous contract shall be entitled to add to the stipulated price an amount equal to the newly imposed tax. This important privilege is extended not only to contracts for the sale of tobacco and spirits, where the newly imposed taxes are heavy, but also to the various excises just described. It is applicable also to the increased stamp tax upon playing-cards. In other words, as

[1] I say, almost; a similar provision is to be found in the civil war revenue act of June 30, 1864. Attention was called to this in the Tariff Commission's Interim Report, referred to below, p. 13.

regards pending contracts, these taxes are treated unmistakably as if designed to be borne, not by the manufacturer or original payer, but by the person to whom the sale is made.

Brief mention will suffice for the newly imposed taxes upon " admissions and dues." One cent is levied for each ten cents of charge or fraction thereof on admission charges for all places of entertainment. It is expressly provided that the tax on admissions shall be paid " by the person paying for such admission." There is also a tax of 10 per cent upon the dues and fees of clubs, where the dues exceed $12 per year. The only phase of the taxes in this group which aroused much discussion was the extent to which they should be imposed upon motion picture shows. In the Senate, the levy was tempered by remitting the tax where the maximum charge for admission, either for motion picture shows or for outdoor amusements, was twenty-five cents. The less liberal House provision, however, was finally retained: the tax is remitted only where the maximum charge for admission is five cents, or in the case of outdoor amusements, ten cents. As regards these taxes, and also those upon tobacco and fermented liquors, there seems to have been no hesitation, such as appeared with regard to the so-called consumption taxes, from levies that would reach the great mass of the community.

IV

Liquors and Tobacco

It was a foregone conclusion from the beginning that an increase would be made in the taxes upon alcoholic liquors and upon tobacco. On tobacco, no other than questions of detail arose in the course of the session. The rates were nearly doubled, as they could be with-

out danger of appreciable diminution of consumption; and a large increase of revenue was certain to be secured with ease.

As regards the taxes upon liquors, the course of events in the session was peculiar. A doubling of the rates both on distilled spirits and malt liquors was proposed at the very first stage, in the bill as reported to the House by the Ways and Means Committee, and a sharp increase was finally retained in the act as passed. In the Senate, however, an episode occurred which caused much delay, threatened at one time to dislocate all calculations of revenue, but finally was without consequences for the tax act itself. An amendment first adopted by the Senate provided for a tax at a prohibitory rate ($60 per hundred pounds) on all grain used in the production of spirits. This was equivalent to complete prohibition of the manufacture of liquor. It left in the air, however, the question of the disposition of the large stocks on hand. A proposal was also made for purchase by the government of these stocks, tho without specific provision as to the final disposition of these stocks by the government itself. The prohibitive tax was finally eliminated from the act, because meanwhile the food administration act had been passed (August 10), entirely prohibiting during the war the use of grain for distillation. The other proposal, for purchase by the government of existing stocks, virtually disappeared entirely. The outcome, so far as concerns the war tax act, thus was that it provided simply for the increase of the taxes on distilled and fermented liquors. The increase on distilled liquors was even greater than had been contemplated at the start. The first proposal had been to double the tax (from $1.10 to $2.20 per gallon); as finally settled, it was made $3.20 per gallon on distilled spirits to be used as beverages. A rate so ex-

tremely high might not have been fixed had it not been for the virtual prohibition of future production and the consequent limitation of the tax to stocks already on hand.[1]

Still another question, of quite a different sort, was raised in connection not only with the internal revenue taxes, but also with the increased tariff duties which, tho not finally imposed, were for sometime under consideration. It related to the mode in which interim conditions should be dealt with; that is, the conditions which repeatedly occur in the interim between the first proposal of increased taxes of this type and their final enactment. The temptation obviously is for importers and other dealers to withdraw commodities from bonded

[1] In detail, the changes on tobacco and liquors are as follows:

	Old Rate	Total under War Tax Act
Tobacco, snuff, chewing and smoking	$0.08 lb.	$0.13 lb.
Cigars:		
Weighing more than 3 lbs. per M if made or imported to retail at less than 4c each	3.00 per M	3.00 per M
To retail at 4c or more each and not more than 7c each	3.00 "	4.00 "
To retail at more than 7c each and not more than 15c each	3.00 "	6.00 "
To retail at more than 15c each and not more than 20c each	3.00 "	8.00 "
To retail for more than 20c	3.00 "	10.00 "
Weighing not more than 3 lbs. per M	.75 "	1.00 "
Cigarettes:		
Weighing not more than 3 lbs. per M	1.25 "	2.05 "
Weighing more than 3 lbs. per M	3.60 "	4.80 "
Distilled Spirits:		
For beverage purposes	1.10 proof gal.	3.20 proof gal.
For non-beverage purposes	1.10 " "	2.20 " "
Spirits Rectified (supplementary tax)		.15 " "
Grape brandy used in fortifying wines	.10 " "	.30 " "
Wines:		
Still wines 14% or less alcohol	.04 wine gal.	.08 wine gal.
over 14% and not over 21%	.10 " "	.20 " "
over 21% and not over 24%	.25 " "	.50 " "
over 24% alcohol	1.10 " "	2.20 " "
Cordials, Liqueurs:		
Containing wine fortified	1½c. per ½ pt. or frac.	3c. per ½ pt. or frac.
Sparkling Wines	3c. " "	6c. ½ "
Artificially carbonated wine	1½c. " "	3c. " "
Fermented Liquors	$1.50 bbl.	$3.00 bbl.

warehouses, or to increase their importation or production, in order to get them safely into the channels of trade before the higher rates go into effect. A step toward meeting this situation had been taken in the Spanish war revenue act of 1898, when the so-called "floor tax," or, as it is sometimes called, the process of "following the goods into the channels of trade was first introduced." A more consistent and wide-reaching effort of the same sort is made in the present act. It is provided that all distilled spirits, for example, held by a retailer in excess of fifty gallons, and by any other person, in any quantity whatever, shall be subject to the additional tax of $2.10. In other words, they shall be subject to the same total tax as the spirits not yet withdrawn from bonded warehouse. On tobacco, something in the nature of a compromise is adopted, similar to that of the Spanish war revenue act of 1898: tobacco and the like, upon which a tax at the previous rate has already been paid, are subjected to a tax of one-half the increase of tax provided for future products.

For all cases of this sort a different procedure had been recommended by the newly established Tariff Commission, in the first report submitted by that body to Congress. The recommendation was for the adoption of something analogous to what are called "padlock laws" in continental Europe. These provide that new taxes, when formally proposed by the executive to the legislature, shall go into effect at once, subject to refund in whole or in part if the proposed changes should not be finally enacted. The same procedure has long been systematically followed in Great Britain. Some modification of procedure would be necessary in this country, in view of the great differences of constitutional arrangement and legislative procedure; and suggestions for possible methods of dealing with the

situation, on the general "padlock" principle, were made by the Tariff Commission.[1] It is certain that the so-called "floor tax" is far from effective. It calls for an enormous volume of petty returns from dealers and retailers, almost impossible to supervise with effect. It imposes a burdensome and expensive task upon the Internal Revenue Department. Some better mode of dealing with the problem, such as was suggested by the Tariff Commission, would seem feasible and highly desirable.

V

Postal Rates; Inheritance Tax

A bitterly contested part of the measure was that concerned with the changes in rates upon second-class matter, that is, periodicals sent by publishers through the mails. The increase in the letter rate from two to three cents, and in the postcard rate from one to two cents aroused debate, but no animated controversy. An enormous amount of time, however, was given to the second-class rate, on periodicals mailed by their publishers. All the world knows that this part of the postal business is conducted at a loss to the government. It is a moot question whether educational and social gains are secured such as to make this loss unobjectionable; and there is in addition the further complication that many publications and great businesses have adjusted themselves to the existing system, and therefore in some sort have vested interests. The outcome is not only a compromise, but one which may be disturbed before it is completely carried through. A division is made in the charges according to the space occupied in periodicals by reading matter and by advertising.

[1] See the report on Interim Legislation submitted by the Tariff Commission to the Ways and Means Committee in April, 1917.

On the space occupied by reading matter, the rate is advanced from the existing figure of one cent a pound to one and one-fourth cents for the fiscal year 1918–19, and to one and one-half cents per pound after July 1, 1919. For the space occupied by advertisements a zone system is adopted — progressive rates as distance increases. These rates are to be gradually advanced during the period 1918–20, a definitive rate finally going into effect for the fiscal year 1922. The whole topic was discussed, and rightly so, as one in which the fiscal element was comparatively subordinate. The need of securing at once a vast increase of revenue for the government naturally caused attention to be given to a part of its operation which involves financial loss; but the details of the changes as made rest upon other than financial reasons. It remains to be seen whether the modifications of general policy which the financial exigencies thus served to bring about will be retained when another occasion presents itself, as it will not fail to do, for further consideration of the postal rates on printed matter.

The inheritance tax, or " war estate tax," provides for an increase of rates over those established by the acts of September, 1916 and March, 1917. The caption " war estate tax," and the circumstance that the form of enactment is that of imposing additions to the previous taxes of the same sort, would seem to indicate that a temporary levy is contemplated, to be maintained only so long as the war lasts. Yet, there is no specific limitation of the estate tax to the duration of the present war. Regarded as a temporary tax, it is obviously objectionable. It reaches the estates of those only who happen to die during the emergency period, and hence inevitably is unequal in its operation. A tax of the same sort, it will be recalled, was imposed during the Spanish War;

after having been in operation for a few years on the estates of those then decedent, it was repealed. Whether there will be a similar outcome from the present measure remains to be seen. Not improbably the accumulated rates — the inheritance tax is fixed by the previous acts, plus the additions now made — will be maintained through a long period, and eventually become a permanent part of the Federal tax system. So maintained, they will raise the whole question of the relation between state and federal taxes of this sort, and may become the initial phase of a movement by which all levies of the kind are concentrated in federal hands.[1]

VI

Income Tax

For revenue purposes main reliance is put upon the income tax and the excess profits tax. The course of legislation regarding these deserves detailed consideration.

It was certain from the start that a large increase would be made in the rates of tax on the larger incomes.

[1] The inheritance tax rates under the three acts, and the total levy finally resulting, are indicated in the following tabular statement:

Net estate	Act of Sept. 8, 1916	Act of March 3, 1917	Act of Oct. 3, 1917	
			Additional rates	Total tax
	%	%	%	%
Not exceeding $50,000	1	1½	½ of 1	2
Exceeding $50,000 but not $150,000	2	3	1	4
" 150,000 " 250,000	3	4½	1½	6
" 250,000 " 450,000	4	6	2	8
" 450,000 " 1,000,000	5	7½	2½	10
" 1,000,000 " 2,000,000	6	9	3	12
" 2,000,000 " 3,000,000	7	10½	3½	14
" 3,000,000 " 4,000,000	8	12	4	16
" 4,000,000 " 5,000,000	9	13½	4½	18
" 5,000,000	10	15	..	..
" 5,000,000 " 8,000,000	..	..	5	20
" 8,000,000 " 10,000,000	..	..	7	22
" 10,000,000	..	..	10	25

All proposals and all tentative drafts suggested income taxes which would reach at least 50 per cent on the largest incomes, or rather 50 per cent on those constituent parts of large incomes in excess of the highest dividing point. The only question in doubt was whether on such constituent parts of the large incomes taxation would proceed to the point of " conscription." Both in the House and in the Senate higher rates were debated and voted on than had been proposed by the two committees — in the House higher rates than had been proposed by the Ways and Means Committee, and in the Senate higher rates than had been proposed by the Finance Committee. Yet the conscription principle, which would look to complete absorption by taxation of all income above a given level, never was soberly entertained. The highest rate proposed by some of the more radical legislators, on the excess of income above some very large sum, say a million dollars, was not considerably above the rate finally adopted. Much as was said in Congress and out of Congress in favor of conscription, nothing quite so radical was put into effect.

Nevertheless, the rates as finally adopted on the very large incomes represent an application of income taxation more drastic than has ever been adopted by any other community at a corresponding stage of exigency. It must be remembered, however, that the highest rates appear only as surtaxes on the excess of income above a given sum. The rate of tax upon an individual's total income obviously depends upon the extent to which his income exceeds the " bracket " within which it falls. The highest surtax, on the excess of income over $2,000,000, is 63 per cent; on an income of $2,500,000, this rate is collected only on the last half million; on an income of $5,000,000 it bears upon three-fifths of the total income.

As it appears from the tabular statement,[1] the significant changes made in the course of the session were the increases in the rates upon the highest incomes. On incomes of $40,000 and less, the changes were inconsiderable. As regards those of larger amount, the trend was to increase the rates at each successive stage of consideration in the House and Senate, and to increase them more as the incomes became larger. The maximum

[1] The following tabular statement shows the surtax rates from 1913 to 1917, and the changes made in the course of the current session.

Income		Surtax		Additional Surtax, 1917					Total Surtax
		Act of 1913	Act of 1916	House Bill as reported by Ways and Means Committee	House Bill as passed by House	Senate Bill as reported by Finance Committee	Senate Bill passed by Senate	Act of 1917	
Exceeding	but not exceeding	%	%	%	%	%	%	%	%
$5,000	$7,500	..	..	1	1	1	1	1	1
7,500	10,000	..	..	2	2	2	2	2	2
10,000	12,500	..	..	3	3	3	3	3	3
12,500	15,000	..	..	4	4	4	4	4	4
15,000	20,000	..	..	5	5	6	6	5	5
20,000	50,000	1	..	..	..	..	..	..	..
20,000	40,000	..	1	6	6	8	8	7	8
40,000	60,000	..	2	8	10	10	10	10	12
50,000	75,000	2	..	..	..	..	..	..	..
60,000	80,000	..	3	11	13.75	12	14	14	17
75,000	100,000	3	..	..	..	..	..	..	..
80,000	100,000	..	4	14	17.5	16	18	18	22
100,000	150,000	..	5	17	21.25	20	22	22	27
100,000	250,000	4	..	..	..	..	..	..	..
150,000	200,000	..	6	20	25	23	25	25	31
200,000	250,000	..	7	24	30	26	30	30	37
250,000	300,000	..	8	27	33.75	29	34	34	42
250,000	500,000	5	..	..	..	..	..	..	..
300,000	500,000	..	9	30	37.5	31	37	37	46
500,000	750,000	..	..	..	..	..	40	40	50
500,000	1,000,000	..	10	..	41.25	..	..	..	..
500,000	....	6	..	33	..	33	..	..	..
750,000	1,000,000	..	..	..	..	..	45	45	55
1,000,000	1,500,000	..	11	..	..	..	..	..	61
1,000,000	....	..	..	..	45	..	50	50	..
1,500,000	2,000,000	..	12	..	..	..	..	..	62
2,000,000	....	..	13	..	..	..	..	..	63

additional surtax, on the largest incomes, was proposed to be 33 per cent in the bill as reported by the House. It became 50 per cent in the measure as finally enacted. Increases roughly corresponding were made in the rates upon other large incomes.

The rates of the income tax were by no means the only problems that called for solution. Closely connected was the change in the amount exempt from taxation. Under the acts of 1913 and 1916 this had been $4000 for married persons, and $3000 for those not married. The exempt amount was now reduced to $2000 and $1000 respectively. A change in this direction had long been advocated by fair minded observers and at no state in the session's discussions was it seriously opposed. As finally enacted, however, it took effect in such fashion as to make quite uncertain what might be the outcome under the definitive rearrangement to which the income tax must ultimately be subjected. The new act simply provides for certain " additional " income taxes. It makes no unified readjustment; it merely adds to or amends certain provisions of preceding statutes. The new provisions by which incomes down to $2000 and $1000 are reached apply only to the new or " additional " normal tax. The tax exemption still remains at $3000 or $4000 as regards the old " normal " tax. It is quite among the possibilities that later legislation will wipe out the " additional " taxes, leaving the provisions of older date untouched. Should this happen, it is conceivable that, without express statement and by inconspicuous steps, the exempt amount will be restored to its old figures.

A new and additional tax was levied as part of the income tax system, upon corporations only, making the total rate upon corporations 6 per cent. The 2 per cent rate of the act of March, 1916, being doubled by the

war revenue measure, already made the general rate 4 per cent. An additional levy of 2 per cent on corporations brought the tax upon their income to 6 per cent. This sort of differentiation of the corporation tax from the general income tax is open to serious question. There is an inevitable tendency, even when the corporation tax is at the same rate as the general income tax, to regard the former as a special levy upon the corporation, — as something in the nature of an excise, not as a constituent part of the income tax system. The corporation itself in any case is inevitably disposed to treat the tax as it treats ordinary local taxes on its tangible property, *i. e.*, as an item to be reckoned among its expenses. The expectation, or the supposedly reasonable thing, is that after meeting all taxes and expenses of every sort the corporation shall be able to pay its normal and reasonable dividends. A corporation subject to public regulation, in presenting its case for higher charges, will lump all taxes in its expense accounts, and will urge, in perfect good faith, that the shareholders are entitled to their dividends after all taxes have been paid. It will not differentiate the income tax as something designed as a levy upon the shareholders and to be deducted from the source of their incomes. This general tendency, in the direction of shifting the tax on users and consumers, is obviously strengthened when the corporation is subjected to a special rate. The tax comes even more to be regarded not as one that serves to reach the shareholders' income, but one that is to be assimilated to other taxes, to be shifted to the general public, and to leave the shareholder's income undiminished. Regarded as part of a permanent income tax system the differentiation is indefensible as a matter of principle, and inexpedient as regards the probable ultimate outcome.

This episode raises once more the whole question whether it is desirable to maintain the practice of levy at the source as regards the income of corporate shareholders. It is by this method that they are supposed to be taxed now; and the result is that people ordinarily consider dividends as "exempt" from the normal income tax. The alternative, as need hardly be said to the conversant reader, is that of information at the source. If dividends were taxed directly to the shareholder and on the basis of a return by him; and if the corporations themselves were called upon simply to give aid in the assessment of the tax by returns showing who are the shareholders and what are the dividends received by each and every one of them — this part of the income tax would not be open to the sort of misconception which is promoted by the established method and still further promoted by the differential rate now established.

It happens that a long step toward the introduction of information at the source, and the cessation of deduction at source, has been already taken. The war tax act has done away with deduction for the two most important classes of income to which that method had heretofore been applied — namely, salaries and the like payments, and interest upon bonds and mortgages. A new section [1] provides that all persons making payments to others (potential taxpayers) amounting to $800 or more in any one year, shall render returns to the Commissioner of Internal Revenues, stating the amount of such payments and the names and addresses of the recipients. It is further required that similar returns shall be made, regardless of amount, for *all* payments of interest upon bonds or mortgages. The provisions

[1] § 1211, which adds six new sections; among these, the new section numbered 28 contains the provision here noted.

formerly in force (under the act of September, 1916, which had replaced those of 1913) for deduction at the source, are now amended so as to be applicable only to very limited sets of cases. Payments to non-resident aliens are still left subject to that process. Perhaps more important is a section by which it is left in effect where interest payments are made on bonds containing the so-called " tax free " clause, by which the obligor under the bond undertakes to pay any taxes assessed on the obligee with respect to principle or income.[1] For this important class of cases, left over from older days, it is provided that deduction at the source may continue; that is, the bond holder shall be subjected to tax through deduction by the obligor, *unless* he files with the latter on or before February 1 of the taxable year a notice in writing claiming the benefit of the stipulation. It is not improbable that a considerable number of persons will fail to send in their notices, and consequently will find themselves unexpectedly mulcted for tax; and the clerical labor involved in classifying the coupons will be onerous.

The new requirement for information at the source with reference to salaries, or other " fixed or determinable gains," is likely to be most important as regards the income taxes now imposed upon smaller incomes, due to the lowering of the exemption from $2000 to $1000. But for some such provision moderate salaries of this range would largely escape. Needless to say, as regards income accruing in the shape of interest upon bonds, the filing and proper assembling of the enormous number of separate items, in such manner as to bring together the constituents of the income of each taxpayer, constitute a task of stupendous magnitude. It is quite uncertain just how great a clerical force will be

[1] See § 1205 of the war tax act.

needed; even more uncertain whether it can be got together, and can accomplish the task. Nevertheless, the mere fact that the information is potentially available, and the common knowledge that returns of this sort have been sent to the Treasury officials, may suffice to bring about full statements from the individual taxpayers, and so contribute effectively to the collection of all taxes due.

One further item in the income tax system deserves notice. Under previous legislation, dividends paid by one corporation to another had been subject to income tax on the net income of the paying company, and had again been subject to tax as constituting part of the income of the holding company. This double taxation — really double — is not indeed abolished, but is restricted within the previous limits. There is no doubling of the "additional" taxes imposed by the new law.

A troublesome question arose with regard to the taxation of the surplus income of corporations — that is, corporate income not divided among stockholders through dividends, but retained as surplus in the coffers of the corporation. Income of this sort, of course, always had been taxable, and remains taxable, at the stated rates applicable to corporations — the rate of "normal" income tax; and it is subject also to the additional taxes on all corporate net income. So long, however, as it remained in the hands of the corporation, surtax rates were not applicable to it, since these relate to the total income of the individual taxpayer. There was a possibility that a corporation, owned and controlled by a small number of shareholders, might divide moderate sums in dividends, and retain in its treasury a large surplus. Such a surplus might then be distributed among the shareholders at a subsequent date, when the cessation of war emergencies would presum-

ably have led to a reduction in the surtax on large individual incomes. The possibility that such accumulation of surplus might be used for the purpose of intentionally and directly evading the income tax had already been faced in the revenue act of 1916, which contained (in section 3) provisions imposing penalties for fraudulent evasion of this sort. But such criminal provisions could not be applicable where a corporation, in the not unreasonable exercise of its discretion, might accumulate a surplus instead of distributing all its profits in dividends.

This possibility was the more troublesome because of another and apparently quite unrelated matter. The excess profits provisions had originally been made applicable to corporations only. As amended by the Senate, they became applicable to individuals also; a change which led to still further complications, as will presently be explained.[1] Once made, it put an end to a rough sort of equipoise which had previously obtained between the combined income and war profits taxes as applied to corporations, and the same taxes as applied to individuals. Individuals and partnerships, like corporations, had always been subject to income tax on their total net earnings. But an individual whose net earnings were large and who reinvested a considerable part of them in his business — which, of course, is analogous to the accumulation of a surplus by a corporation — was nevertheless subjected to a surtax upon his entire income, whether it inured to him in the form of cash or in the form of a reinvested business surplus. The same was the situation with a partnership. Under previous legislation, accordingly, an individual (and *pro tanto* a partner) had been at a disadvantage so far as concerned the application of the surtaxes on any

[1] See below, pp. 29, 30, 34.

surplus invested by him in his business; since no surtaxes were levied with respect to corporate surplus. On the other hand the individual had enjoyed some advantage under the excess profits tax as it was framed in the act of March, 1917, and as it had been retained in the House bill; for corporations only, not individuals, were subjected to that tax. The Senate bill, in subjecting individuals to an excess profits tax, deprived him of this advantage. The question naturally presented itself whether corporations should not also be deprived of the roughly corresponding advantage which they had, or rather which their shareholders had, from the circumstance that surplus accumulations in the hands of corporations were not within the purview of the surtax on large incomes.

The problem was a difficult one because of the extraordinarily varying conditions under which corporations accumulate their surpluses. No doubt, in some cases the accumulation may be due to a design of evading, or rather of diminishing, income taxes. In other cases doubtless it is due to speculative manipulation — accumulation of a hidden surplus, known only to the insiders and expected to become the occasion for "melon cutting" at a future date. In the great majority of cases, corporate surplus is doubtless due to conservative management — the desire of providing against the uncertainties of industry or of maintaining the basis of good credit. Railroad corporations have certainly accumulated no surpluses with an eye to the consequences for income taxation, and sound public policy is in favor of encouraging rather than discouraging a moderate dividend policy upon their part. The same is probably true of most manufacturing enterprises.

After prolonged debate, and consideration of many alternatives, two provisions were inserted, in different

parts of the act, which combine to bring a satisfactory solution. On the one hand, an additional tax of 10 per cent is imposed upon any surplus left undistributed by a corporation six months after the end of its fiscal year. This tax, however, is not to be applied to surplus "actually invested and employed in the business or retained for employment in the reasonable requirements of the business" — a limitation which prevents it from standing in the way of conservative management carried out in good faith.[1] On the other hand, it is provided[2] that the term "dividends" shall include stock dividends; and any distribution, of whatever kind, made to stockholders, shall be taxed to the distributees at the rates of tax in force for the years in which the profits or surplus were accumulated. It is also provided that the distribution shall be deemed to have been made from "the most recently accumulated undivided profits or surplus"; that is, shall not be made to appear, by any bookkeeping entry or by any vote or declaration *ad hoc*, to have been made from the profit of some earlier date selected by the corporation. In other words, income from surplus, when finally received by a shareholder, is to be taxed not at the rates in force at the time of his receipt of them, but at the rates which were in force at the earlier date, perhaps much earlier, when the profits were accumulated by the corporation. By this device a deliberate withholding of surplus in order to escape war surtaxes is prevented, or at least becomes without object. The enforcement of the provision obviously may raise complications with regard to the rates of the surtaxes. Some retroactive application will be inevitable, and nice legal questions may arise.

[1] § 1206, (2) b.

[2] In § 1211, and the new section numbered 31 there added to the administrative provisions.

The income tax, as thus amended and amplified, has in many respects been improved. But it has certainly become complicated, and difficult of construction and administration. The provisions which are now in force must be sought partly in the act of 1913, partly in that of September, 1916, and partly in the war tax act. Some of the new provisions are obviously designed to be temporary; others are expected to be permanent; some may or may not remain part of the permanent system. It is obvious that an overhauling of the whole will be necessary at the close of the war, and it is extremely desirable that there should be not only a codification, but complete revision. The income tax will prove for many years to come, indeed for as long a time as we can foresee, among the largest sources of Federal revenue, probably the very largest. The task of putting it into consistent and usable shape cannot be taken in hand too soon.

VII

Excess Profits Tax

By far the most important, the most significant and most hotly debated part of the measure is that which elaborates the excess-profits or war-profits tax. From this also by far the largest immediate contribution to the public revenue is expected.

It will be recalled that the preceding Congress, by the act of March, 1917, had already levied an excess-profits tax. This, however, was at a moderate rate and on a simple plan. The rate was 8 per cent; the plan, to treat all profits in excess of 8 per cent on capital as excess profits, and to tax these at the rate of 8 per cent. The plan necessarily involved some definition of the " capital " upon which the exempt return of 8 per cent

was to be calculated. The war tax bill, as it passed the House in the current session, went no further than simply to double the rate, leaving the plan unchanged. All profits over 8 per cent on capital were to be taxed at the rate of 16 per cent.

Capital was defined in terms substantially the same as those of the earlier act, namely, to include first, cash paid in; second, cash value of property, other than cash, paid for in stock or shares; third, surplus or undivided profits; with, however, an added provision that intangible assets, such as goodwill, trade-marks, franchises, should not be reckoned at all, unless specifically paid for in cash or in tangible property.[1]

The importance of the definition of "capital" obviously became greater as the rate of tax was raised. The definition of "capital" as "actual cash paid in," "actual cash value of property paid in," "paid in or earned surplus" was a device of doubtful serviceability toward assuring effective collection. On the books of a corporation its stated capital stock will appear, in the immense majority of cases, as having been paid in. A tax administrator finds it difficult to go behind the books of a corporation. On the other hand, the capitalization of most corporations has adjusted itself to their earning capacities, and a tax merely on the excess over a return of 8 per cent on capitalization would be extremely uncertain as regards revenue. It would also be unequal in its operation on different sorts of corporations, penalizing those undercapitalized and giving a virtual bonus

[1] The precise language of the House bill was: "For the purpose of this title, actua capital invested means (1) actual cash paid in, (2) the actual cash value of property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment, and (3) paid in or earned surplus and undivided profits used or employed in the business: *Provided*, That the goodwill, including trade-marks and trade-brands, or the franchise of a corporation or partnership, is not to be included in the actual capital invested, unless the corporation or partnership made payment therefor specifically as such in cash or tangible property, the value of such goodwill, trade-marks, trade-brands, or franchise, not to exceed the actual cash or actual value of the tangible property paid therefor at the time of such payment."

to those overcapitalized. The difficulties of applying the House plan in such manner as to yield a large revenue and at the same time to deal fairly with the extraordinarily diverse kinds of corporate enterprises led to a complete change of plan in the Senate.

The change proposed in the Senate was from an *excess*-profits tax to a *war*-profits tax. It was based in the main, on the British example. A pre-war period was defined, consisting of the years 1911–12–13. The average profits for this period were made to constitute a base; profits in excess were treated as war profits and subjected to the new tax. With the change of base, there was proposed also a new method of levy; graduated steps in place of a flat rate, the graduation to take place after the method followed in the income tax. Each successive increment of profit was to be subjected to a higher rate of tax, always levied on the amount by which it exceeded the preceding increment or "bracket." While the shift to a graduated rate met with general approval, that to a strict war-profits tax encountered vehement opposition, which led finally to a complicated compromise.

The Senate proposal had one advantage; a tax on the pre-war basis was comparatively easy of administration. The profits of corporations which had been in operation during the pre-war years were on record in the Internal Revenue Office. Under the corporation tax act of 1909, they had been there recorded for the years 1911 and 1912, and under the income tax of 1913 for the third year of the period selected. Accordingly it would only have been necessary, in the ordinary case, to reckon the average profits as thus recorded, to compare with them the profits returned in the income tax statements for the year 1917, and then proceed to the calculation of the taxable excess.

Certain complications, however, necessarily had to be faced, nor was it easy to dispose of them without undertaking at some stage an appraisement of invested capital. Three types of exceptional cases called conspicuously for treatment. One was the new corporation, not in existence during the pre-war period. Another — what might be called a subnormal case — was the corporation whose profits were exceptionally low during the pre-war period. There was an obvious hardship in taxing heavily a concern which had been unprosperous during the earlier period, and whose profits during the taxable year, tho perhaps much in excess of the slender or non-existing profits of the pre-war period, nevertheless were at no high rate. The third case was the converse of the second — what might be called the supernormal case. A concern might have been extremely profitable during the pre-war period, and also profitable during the taxable year, yet no *more* profitable than before. Under a strict application of the war profits principle it would not be subjected to a war profits tax, even tho inordinately prosperous.

As first elaborated in the Senate, these complications were disposed of with an undeviating adherence to the war-profits principle. The first case, that of corporations entirely new, was to be dealt with by the device of what economists would call the representative firm. New concerns were to be taxed by ascertaining what were the war profits of " representative corporations engaged in like or similar trade or business "; their war profits were to be deemed to bear the same proportion to their net income as the war profits of such a representative concern bore to its net income. Similar treatment was proposed for corporations which could show their net return during the pre-war period to have been low as compared with the net return during the same

period of like representative concerns. No special consideration, however, was given to the supernormal cases, in the plan as first submitted to the Senate. The corporation prosperous during the pre-war period, but not more prosperous during the taxable year, was to be consistently treated as not liable to any special war profits tax. It was to be subjected to the income tax only.

Debate in the Senate itself, however, soon showed that an unqualified application of the war profits principle could not be carried through. True, it was logical, and consistent with the general principle of calling upon profits *due* to the war to pay expenses incurred *for* the war; but it roused vigorous opposition from those who could not be content to let unusual gains of any kind escape the unusual burdens. Much was said, for example, of the great tobacco manufacturing enterprises, profitable before the war and no less profitable during the war. That these and others like them should be called upon for substantial contributions to the war expenses seemed to the common man to be the dictate of common sense. A return to the House principle, that of taxing all profits in excess of a specified moderate return on invested capital, difficult tho this might be in administration, was urged as essential for a just apportionment of the general burdens. The opposition to the strict war profits plan was further strengthened by the desire of the more radical members of Congress to put on the screws more heavily in every direction, not only by increasing the surtaxes on incomes but by subjecting all excess profits of every kind to rates much higher than were proposed by the Senate Committee. In the face of growing opposition from more than one quarter, a compromise was elaborated in the Senate Committee and adopted in the Senate. By this, regard was to be had, after all, to invested capital and the rate of return upon

it. The basic amount was still to be, in general, the total of pre-war profits; but it was also provided that it should be not " less than 6 per cent nor more than 10 per cent of the actual invested capital for the taxable year." This provision might seem to suffice for disposing of the cases both of subnormal and supernormal profits. Nevertheless, a special clause was retained providing for cases in which the net return was unusually low. There was also special provision for corporations which had not been in existence at all during the pre-war period. For these contingencies — the concern with very low profits, and that which had not been in existence during the pre-war period — the device of the representative firm was still to be used in order to ascertain normal or non-excess profits.

It was in this form that the matter went into the hands of the Conference Committee — already a compromise between the two essentially different plans of levy. Protracted and doubtless vigorous discussion in the Conference Committee led to still further compromise. The provisions as finally enacted thus bear an appearance of inconsistency. The apparent or real inconsistencies or ambiguities, and many details in the phraseology of certain sections, can be understood only in the light of the history of the measure.

The term " pre-war period " is retained, and some use is still made of the profits of the pre-war period as a basis. But the application of the war-profits principle is limited to the range where the net income (profits) is 15 per cent or less on the invested capital. Within this range the tax is to be levied at the rate of 20 per cent, upon the excess over the profits of the pre-war period. But, the basic sum [1] is to be not less than 7 per cent or

[1] The term used in the act is " the deduction " — that is, the sum to be deducted from total profits (" net income ") in order to ascertain the excess which is taxed. The lump sum of $6,000 is also to be free of the tax for all domestic partnerships and individuals, and of $3000 for all domestic corporations.

more than 9 per cent upon the capital for the taxable year. The range within which the rigorous war-profits principle is left applicable thus becomes very narrow. And this principle, hedged in even in its application to concerns with moderate profits, is given up entirely as regards larger profits. So far as the net income on invested capital is more than 15 per cent, it is not applied at all. The method then becomes that of the House bill, namely, an unqualified tax, quite without regard to pre-war profits, upon the excess over a stated percentage of earnings upon capital. The scale, as already noted, is a graduated one; on this point there was no serious disagreement.[1] There remain, however, incorporated from the Senate bill, certain other provisions which give considerable discretion to the Treasury Department and still make possible some use of the "pre-war" basis. The device of the representative firm may still be used in case of subnormal profits, and in cases where the amount of the invested capital is not made out to the satisfaction of the Department. How important a part discretionary powers of this sort will play in the administration of the act remains to be seen.

Obviously under this scheme the definition of capital becomes of crucial importance. It is defined to include: (1) cash paid in; (2) cash value of tangible property paid for stock, with the provision that such property be reckoned at its value as of January 1, 1914, but no more

[1] The graduated rates of the tax are as follows:

20% if profits are 15% or less.					
25% on the excess over 15% and not over 20%					
35	"	"	20	"	25
45	"	"	25	"	33
60	"	"	33		

It should be borne in mind that the complicated reckoning for the first 20% of tax (on profits of 15% or less) will have to be gone through for each and every taxable concern or individual; since the higher rates of tax are applicable only to the successive excesses over the stated percentage of profit.

than par of the stock; (3) earned surplus and undivided profits. The much disputed question of the allowance for " intangible " property is settled by making separate provision for patents and copyrights on the one hand, and for goodwill, trade-marks, and franchises on the other. Patents and copyrights, may be rated at their cash value at the time when paid for, even tho paid for not in cash but in stock or shares of the corporation. Goodwill, trade-marks, trade-brands and franchises may be included for the amount paid for them in cash or in tangible property. If paid for, however, in shares of the corporation, only an amount equal to 20 per cent of the total share capital may be included, and this further to an amount not to exceed the cash value at the time of the exchange of the intangible property for the shares. There is no substantial ground for criticising the definition of invested capital thus hammered out through protracted discussion. How manageable it will prove to be as a means of enabling the Treasury Department to collect excess profits according to the intent of the law is quite another question; and it would be rash to make predictions.

An unexpected result of the revision of the excess profits scheme in the Senate is the imposition of a special tax upon the incomes of individuals. As framed in the act of March, 1917, and as framed also in the House bill, the excess profits tax had been limited to corporations. Individuals and partnerships were not to be reached at all. In the Senate, for reasons which have already been explained,[1] it was proposed that individuals also should be subjected to it. The inclusion of individuals, in some form and with reasonable limitations, is incontestable, even tho, in these days of ubiquitous corporate organization, the quantitative significance of their inclusion

[1] See above, page 25.

is not likely to be great. Some theoretic difficulties undoubtedly there are in applying the principle to individuals; and on general grounds of economic analysis some limitation is desirable. In a corporation, wages of management are deducted before net profits are demarcated; salaries of managers are part of the corporation's expenses. In the case of individuals, this is not done, and even in the case of partnerships is probably not often done. The excess profits tax, as applied to individuals, therefor, bears upon larger constituents of gain than it does when applied to corporations, and is likely to become in effect more burdensome.

Difficulties of this sort would be less serious on a war profits basis than on an excess-profits basis. If the original Senate plan of a strict war-profits tax had been carried out — if the basis of liability had been the mere excess over pre-war profits — the operation of the tax on individuals would probably have been as reasonable and as equitable as can be expected of any device of this sort. The modification of the war-profits plan, however, in the act as finally passed, was so great, and the excess profits principle was so completely substituted for it, that the application of the tax to the profits of individuals presented virtually a new question, and one which, in the rush of the closing days of the session, could not be considered with much care or deliberation. It was urged that since corporations paid the tax on the excess of earnings over a given basis or minimum, individuals also should pay the tax on earnings over an analogous basis or minimum; and individuals finally were included.

The definition of the terms " business " or " trade " is expanded so as to include " professions and occupations." In another paragraph, individuals engaged in any " trade or business " — that is, including occupa-

tions or professions — are subjected to a tax of 8 per cent upon the excess of their incomes over $6000.[1] The consequence is that labor incomes (of the higher range) are subjected to heavier taxes than property incomes of the same range. Not only the individual engaged in business and securing what the economists would call " business profits," but the physician, lawyer, engineer, salaried manager, is called upon to pay a tax of 8 per cent on the excess of his income over $6000. That same individual, of course, is liable also to the surtaxes levied under the income tax. On the other hand, the person deriving an equal income from property is subject to the income surtaxes alone. A discrimination is made quite the reverse of that long advocated for our own income tax, and practiced in the income tax systems of most other countries — a discrimination in favor of the property income, and to the disadvantage of the labor income.

One cause of this unexpected and probably unwelcome outcome is doubtless to be found in failure to perceive that the general reasoning which underlies the excess profits tax is not applicable to labor incomes. That reasoning implies a minimum of reasonable or ordinary or normal gains; only the excess above such a minimum is to be taxed. A return of 8 per cent upon capital was treated as reasonable in the act of March, 1917; and some such figure underlies the more complicated provisions of the present act. Whatever figure is accepted, is assumed to be equally applicable to all investments of capital, equally reasonable for all. As a matter of economic theory, the assumption doubtless is open to some criticism. Industries in which risk is large, or in which the need of able management is particularly great, may be fairly entitled to a higher rate of

[1] See § 200, toward the end; and § 209.

return than humdrum industries, and the excess above the minimum or reasonable return should doubtless be calculated for them with some regard to their special conditions. But differences of this sort must perhaps be disregarded in that rough approximation to ideal justice which is alone attainable in tax legislation. A similar assumption, however, of a uniform minimum of return, applicable to all sorts of cases, is not even roughly or approximately true as regards the earnings of individuals. There is here no one level rate of return which can be regarded as reasonable or normal. An income of $6000 for instance — the figure which has become the basic amount of this extension of the excess profits principle — is more than ample for most men and most occupations, yet far from reasonable or normal for other men and other occupations. No economist would maintain that there is an average fair rate of earnings for individuals in the sense in which there is an average fair rate of return to capital. An able physician, engineer, lawyer, manager, may receive a salary of $20,000, and yet be earning nothing in the nature of an excessive gain in the sense in which a corporation earning 20 per cent upon its capital stock may be said to be earning excessive profits. The earnings of individuals would seem to be fairly subject to income tax only, and not to be within the purview of an excess profits tax. On these grounds of general reasoning, as well as because of the discrimination against labor incomes as compared with property incomes, the new proviso is seriously open to attack.

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